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# CZAR RESOURCES LTD.

## 1987 ANNUAL REPORT



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## Abbreviations

Throughout this report standard oil and gas abbreviations have been used. Their explanation is as follows:

BBLS	Barrels
MSTB	Thousand Stock Tank Barrels
BOPD	Barrels of Oil Per Day
MMCF	Million Cubic Feet
MMCF/D	Million Cubic Feet Per Day
BCF	Billion Cubic Feet
NGL	Natural Gas Liquids

## Annual Meeting

The Annual Meeting of Shareholders of Czar Resources Ltd. will be held on June 16, 1988, at 3:00 p.m. in the Bonavista Room of the Westin Hotel, Fourth Avenue and Third Street S.W., Calgary, Alberta.

### PLEASE NOTE:

If you are a registered shareholder of Czar Resources Ltd., please direct any queries regarding changes of address, loss of certificates, etc. to our transfer agent, The Canada Trust Company, at their Calgary office.

If you are not registered with the transfer agent and receive material from the Company directly, please send any changes of address to Czar Resources Ltd. in Calgary.



## Highlights

### FINANCIAL

	1987	1986 (1)
Gross revenue	\$13,692,139	\$13,830,375
Cash flow from operations	\$ 4,929,976	\$ 2,449,045
Cash flow per share	\$ 0.20	\$ 0.18
Net earnings	\$ 1,895,575	\$ 2,322,361
Net earnings per share	\$ 0.07	\$ 0.17
Capital expenditures	\$ 4,709,343	\$ 6,044,930
Total assets	\$41,814,266	\$41,915,931
Common shares outstanding	27,052,406	12,828,521

### OPERATING

Production (before royalties)		
Crude oil and natural gas liquids (BBLs)	148,312	165,560
Average daily production (BOPD)	406	454
Natural gas (BCF)	8.8	7.3
Average daily production (MMCF/D)	24.2	20.0
Drilling Activity		
Gas completions	22	21
Oil completions	1	0
Dry and abandoned	9	6
Total Wells	32	27
Undeveloped Land Holdings		
Net Acres		
Alberta	49,069	46,178
British Columbia	110,673	104,613
Total Net Acres	159,742	150,791

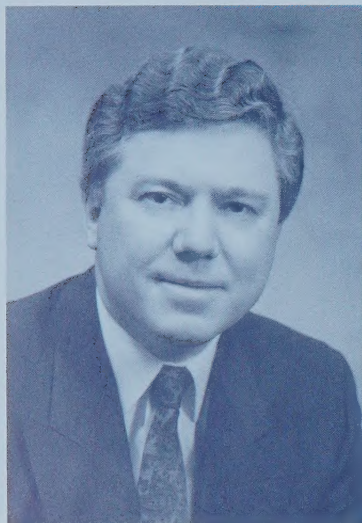
(1) Figures reported for 1986 are for the twelve months ended December 31, 1986.

	OIL (MSTB)	GAS (BCF)
<b>RESERVES</b> , before royalties, at December 31, 1987		
Proved and probable	1547.8	178.2



## To The Shareholders

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"CZAR'S 1986 FINANCIAL RESTRUCTURING HAS ALLOWED THE COMPANY TO RESUME AN ACTIVE, EXPANDING ROLE IN THE CANADIAN ENERGY BUSINESS"

I am pleased to report that for the year ended December 31, 1987, the Company continued to achieve satisfactory growth in its financial and operating results.

As a result of a refinancing entered into in 1986, and completed in late 1987, the Company substantially reduced its debt servicing costs and, through the steady development of new gas fields, expanded natural gas sales to record levels. Cash flow from operations doubled from cash flow in 1986, and most of the Company's target financial ratios were dramatically improved.

As a measure of the Company's return to financial stability, a number of refinancing alternatives were considered during the year and only the market decline in October, 1987 prevented the Company from resuming the role of an active securities issuer.

### Business Objectives

"CZAR'S CONCENTRATION ON GAS HAS ENABLED IT TO SURVIVE THE 1980's AND WILL POSITION THE COMPANY FOR STEADY GROWTH IN THE 1990's"

The primary aim of Czar's management in the past six years has been to hold the Company's asset base intact in the anticipation of the eventual turnaround in natural gas sales. In addition, the Company has restricted its capital expenditures to available cash flow while attempting to replace or bring to market its remaining gas reserves.

It is now apparent that the turnaround in the energy business has been delayed so long that most of the assumptions made in 1982, including a rapid recovery in the business, are no longer relevant. However, the Company has benefited from the conservative nature of its operating plan and despite the fact that greatly reduced gas prices have virtually offset the doubling of Czar's production, the overall operating strength of the Company has greatly improved. While these improvements have been camouflaged by the deterioration of gas prices, Czar is now in a good position for rapid financial improvement when gas prices eventually rise.

During the period of Czar's financial difficulties, it was obvious that the marketing of its developed reserves would be virtually the only way of reviving the Company's financial position. Furthermore, upon greater examination, it became apparent that gas commodity fundamentals in North America were superior to those of oil and that the company's concentration on gas was warranted. Gas supplies in the lower 48 United States are declining, and a probable end to the prolonged gas bubble could be anticipated by the early 1990's.

One of the most pronounced trends of United States gas reserves is that they have declined in almost every year since 1965, with total reserves in 1986 at the lowest level since 1945. The analysis of supply and demand of gas is complicated by recent declining demand, the long period in the U.S. when prices were artificially controlled, and recently by low oil prices and consequent interfuel competition. However, an overall analysis would indicate that, due to



current gas price competitiveness and the reduction of the number of gas wells being drilled in the United States, the gas bubble will soon disappear and prices increase.

Czar has therefore incorporated into its long range planning the intention of positioning itself properly to benefit from increased gas prices by vigorously attempting to develop its reserves and gas market share to the virtual exclusion of any other activity.

The end result has been most gratifying in that for the year ended December 31, 1987, the Company had:

- doubled its cash flow to almost the highest in the Company's history,
- maintained its reserves to the point that at year-end, the Company controlled 178 billion cubic feet of proven and probable gas reserves,
- achieved record and steadily rising gas sales,
- gained recognition as a leading and competent gas marketer,
- positioned itself to greatly benefit from new long term gas contracts.

The Company intends to continue in this business mode for the foreseeable future while striving to improve its financial base.

### Outlook

"THE COMPANY'S FINANCIAL STABILITY AND EXCITING GROWTH PROSPECTS SHOULD ALLOW FOR STEADY EXPANSION IN 1988"

In general the outlook for energy companies in 1988 is again positive as the negative impact of the 1986 oil price drop has been greatly reduced due to a combination of greater cost control, restricted reinvestment policies, improved government taxation and incentive regimes and a generally more cautious businesslike approach in those companies which have survived the long downturn.

For Czar specifically, the gas marketing scene has recently improved very much for the better:

- gas deregulation is now virtually complete in North America and the Company can sell to a great variety of purchasers at market clearing prices,
- a recent gas pricing spike in California during the winter of 1987-88 has resulted in generally higher prices and a new awareness of potential supply problems among end-users,
- the opening of Northwest Pipeline Corp. under a form of open access early in February is also particularly beneficial for British Columbia producers such as Czar, as a remaining bottleneck to the U.S. market for surplus reserves from that province has now been removed,
- early in 1988 the Company entered into two long term gas contracts to supply up to 270 BCF from reserves of Czar and other working interest participants.



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The key to the Company's future is the radical improvement in the balance sheet which was finalized in 1987. The savings in financing costs are substantial in their own right, but more importantly, the refinancing has allowed Czar to rejoin the group of companies which can periodically market their securities. Future financings will enable the Company to gradually completely rectify its debt leverage situation.

The Company is dedicated to continuing its business plan of maintaining its tight expenditures control, and with the long term benefits of its new gas contracts, anticipates entering the 1990's with an acute awareness of how to successfully benefit from the next energy cycle.

I would like to take this opportunity to thank the staff for another year of very successful efforts on the Company's behalf.

A handwritten signature in dark ink, appearing to read 'R.W. Lamond', with a long horizontal stroke extending to the right.

R.W. Lamond  
April 22, 1988

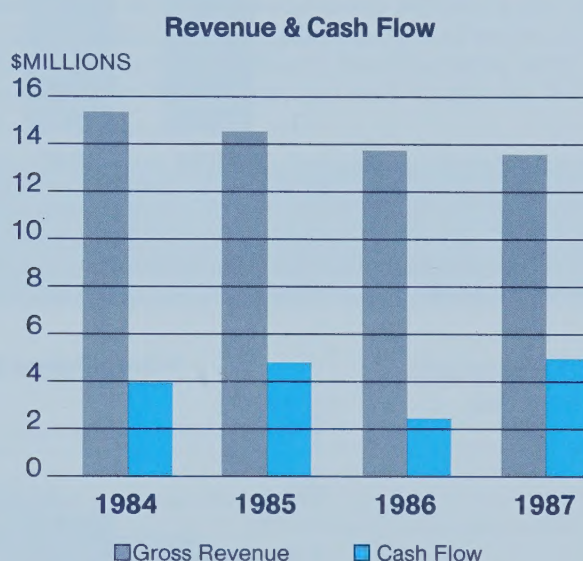


## Financial

**"CZAR HAS IMPROVED ITS CASH FLOW AND OPERATING SOUNDNESS WHILE GREATLY REDUCING FINANCIAL LEVERAGE"**

Increased production volumes offset lower gas prices and resulted in gross revenue for 1987 of \$13.7 million which is comparable with \$13.8 million in 1986. Reduced financing charges as a result of a refinancing effective October 30, 1986 increased cash flow to \$4.9 million compared with \$2.2 million for the prior year.

Earnings before extraordinary items totalled \$1.5 million compared with a loss of \$350,000 in 1986. During 1986, the Company sold its United States subsidiary and recorded an extraordinary gain of \$2.7 million for the year.



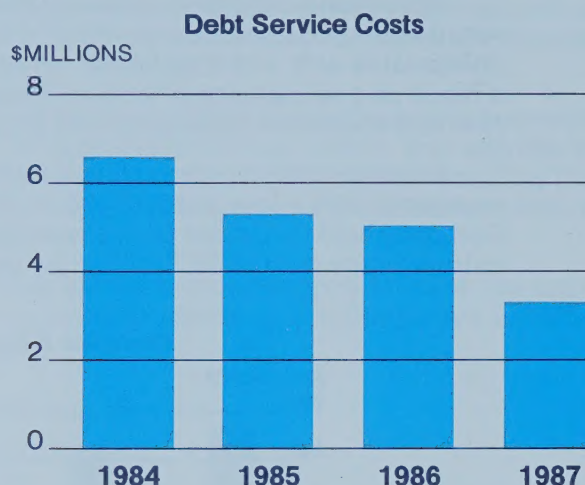
During the year, the Company utilized both its cash flow and flow-through share funding in order to finance its capital expenditure program. The Company also benefited from the Federal Government's Canadian Exploration and Development Incentive Program and other programs, which were effective during 1987 to assist smaller energy companies in this period of pricing weakness.

Funding for the capital program was derived from:

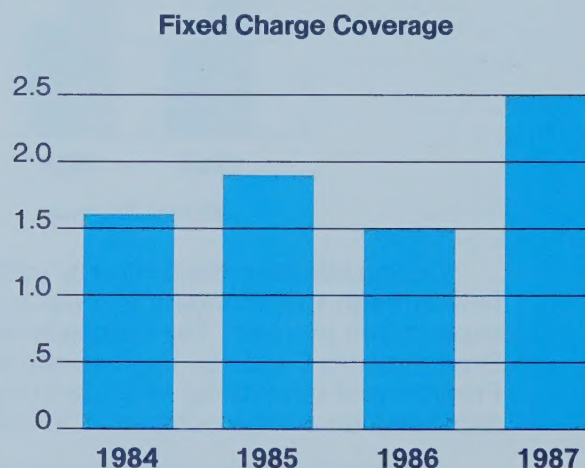
	\$Millions			
	1987	1986	1985	1984
Cash flow	2.7	2.4	4.8	3.8
Flow-through shares	2.0	2.9	—	—
Incentives	1.5	—	0.1	—
Working capital or debt	—	.7	2.1	—
<b>TOTAL</b>	<b>6.2</b>	<b>6.0</b>	<b>7.0</b>	<b>3.8</b>



The Company's expenditure program continued to be conservative and in addition, a portion of Czar's cash flow was set aside to reduce bank debt.



As a result of lower financing charges, the Company's coverage of fixed charges from cash flow reached 2.5:1, the highest achieved during the Company's period of financial difficulty.



The Company's external financing activities related to the placing of \$2 million of flow-through shares with National Investors Management Ltd. The Company also entered into a flow-through share agreement with CMP Funds Management Ltd., which resulted in the expenditure of \$600,000 in early 1988.

In September, 1987, the Company filed a preliminary prospectus for a proposed issue of common shares which was withdrawn as a result of the general stock market decline which soon followed. Subsequent to the reporting period, on April 22, 1988, the Company filed a preliminary prospectus for the issue of \$10 million of 8.75% Convertible Debentures. Proceeds from this issue will be used to reduce bank indebtedness and fund ongoing capital expenditures.



## Production

**"STEADY GAS SALES INCREASES HAVE RESULTED IN CZAR NOW BEING A SUBSTANTIAL AND WELL RECOGNIZED GAS MARKETING COMPANY"**

As a result of new wells being connected to market, gas sales increased by 21% to 24.2 MMCF/D, compared with 20 MMCF/D in 1986. Oil and natural gas liquids production declined to just over 400 BOPD due to a natural decline of the wells and the reduced allowable, early in the year, on a well in which Czar owns a significant interest.

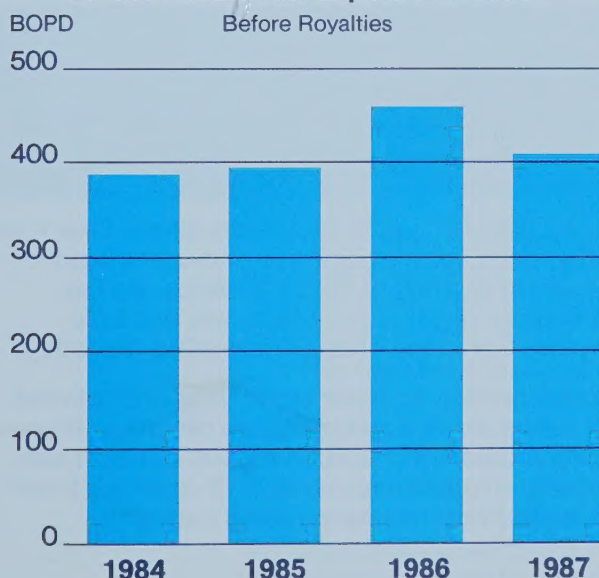
Czar placed a number of high working interest wells on stream early in 1988, which will significantly increase gas sales for the year.

Average gas prices received by Czar were markedly lower than those for 1986, while oil prices recovered slightly from their low 1986 level. Fortunately however, it appears that some stability is now developing in prices during 1988 and the Company anticipates that the long drawn out decline in both gas and oil pricing is finally coming to an end.

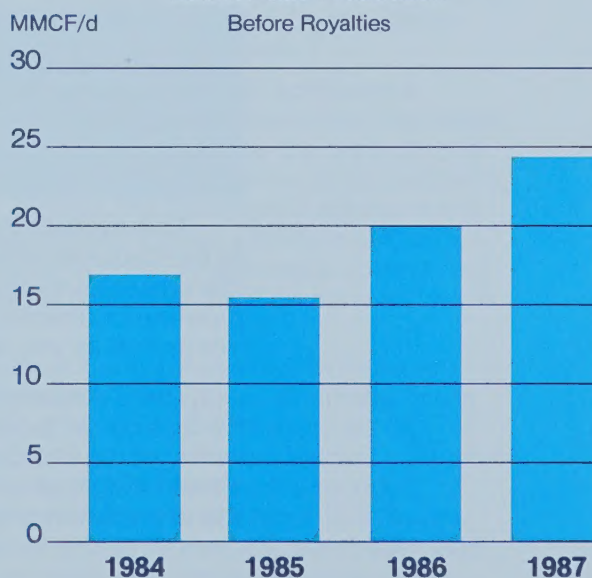
### Average Product Prices

	1987	1986	1985	1984
Oil and NGL — \$/BBL	19.10	17.47	36.26	34.99
Gas — \$/MCF	1.33	1.69	2.07	2.11

### Oil and Natural Gas Liquids Production



### Natural Gas Production





## Reserves

"CZAR'S EFFORTS TO MAINTAIN ITS RESERVE BASE HAVE RESULTED IN THE COMPANY'S OWNERSHIP OF A LARGE GAS INVENTORY WITH MAJOR UPSIDE POTENTIAL"

The Company's oil and natural gas properties, before deducting royalties, as evaluated by an independent petroleum engineering company at December 31, 1987, are summarized as follows:

	Oil & NGL (MSTB)	Natural Gas (BCF)	Estimated Cash Flow Including Alberta Royalty Tax Credits Present Value	
			Undiscounted	Discounted at 15%
Proved Producing	1,067	65,012	\$107,149	\$41,731
Proved Non-Producing	416	84,420	156,373	32,826
Proved Undeveloped	—	9,166	14,093	2,339
Total Proved	1,483	158,598	277,615	76,896
Probable*	65	19,561	35,815	5,696
Total Proved & Probable	1,548	178,159	\$313,430	\$82,592

\*The estimates of probable reserves have been reduced by 50% to reflect the degree of uncertainty associated with the properties.

The Company's natural gas reserves are divided almost equally between Alberta and British Columbia.

	Alberta	%	B.C.	%
Proved Producing	24,981	27	40,031	38
Proved Non-Producing	52,388	56	41,198	40
Probable	8,104	17	11,457	22
TOTAL	85,473	100	92,686	100

This availability of reserves from both provinces allows Czar's gas to be marketed through a variety of trunklines to end-users both in the eastern and southwestern regions of North America, and as pipeline connections between the two provinces are not fully integrated as yet, allows the Company greater marketing flexibility.

The Company's proved producing reserves at year end totalled 65 BCF, or 37% of Czar's total proved and probable reserves. New wells, which the Company expects to place on stream during 1988, should move, at a minimum, an additional 10 BCF of reserves from the proved non-producing to the proved producing category.



## Natural Gas Marketing

"CZAR'S MARKETING STRATEGY AND ACCOMPLISHMENTS IN ITS SELECTED MARKETING AREAS HAVE RESULTED IN STEADY GROWTH AND ENHANCED CREDIBILITY".

During 1987, the Company continued its policy of maintaining existing gas markets where possible, and expanding into new areas according to the Company's long range gas marketing plans.

Total gas sales to industrial markets declined slightly in 1987 from the volumes marketed during 1986 mainly due to two factors. The primary factor was that Czar produced during the year to non-industrial purchasers at virtual maximum capacity from its presently connected wells and secondly, a work stoppage at one of the Company's larger British Columbia users restricted gas sales to that market.

### Direct Gas Sales (BCF)\*

	1987	1986	1985	1984
Alberta — Industrial	9.3	8.7	7.8	9.7
B.C. — Industrial	5.5	8.0	2.0	1.5
U.S. — Export	2.2	1.1	2.3	—
TOTAL	17.0	17.8	12.1	11.2

\*Includes Czar & other working interest participants

Czar's basic marketing strategy has been to sell its gas production at market competitive pricing to yield sufficient cash flow to enable the Company to meet its financial obligations and upgrade and expand its reserves base. The Company has been a vigorous proponent of deregulation in the various gas marketing areas of North America in which it is active and has in part assisted, by regulatory intervention, in speeding up the deregulation process.

However, while these efforts have satisfactorily achieved a number of the Company's business goals, it is apparent that the highly competitive short term gas market does not provide the type of long term assured take and pricing stability which system supply contracts afford to producing companies. Hence, the Company's efforts in the past 18 months have tended towards dedicating a portion of Czar's gas reserves to long term contracts in order to achieve a contracting framework wherein future gas wells drilled by the Company will have an assured market outlet.

The results of these efforts have been successful. In February 1988, the Company entered into a long term gas sales arrangement with Kanngaz Producers Ltd. under which approximately 50 BCF of Alberta gas reserves of Czar and its working interest participants have been dedicated for a fifteen year term. This contract, which will initially serve Quebec industrial purchasers and a large U.S. buyer, will gradually be switched to serve primarily the U.S. purchaser, and is expected to lead to steady gas takes with higher average prices than purely industrial markets will provide.

Of even greater significance to Czar however, is a contract which the Company entered into in April, 1988 with Alberta and Southern Gas Co. Ltd., to supply up to 220 BCF of natural gas from properties held by Czar and its working interest participants in northeastern British Columbia. This is a long term sale, with deliveries commencing at 15 MMCF/D in 1990, and increasing to 40 MMCF/D in 1992. Alberta and Southern, which primarily services the California market, is one of the most noted exporters of Canadian gas and has historically achieved higher than average netback prices and sales volumes on behalf of its producers.



## Exploration

"CONCENTRATION ON READILY MARKETABLE GAS PROSPECTS HAS RESULTED IN STEADY INCREASES IN ANNUAL GAS SALES AND AN IMPROVED INVENTORY OF GAS RESERVES"

Due to Czar's limited capital, the Company has concentrated in the past five years on gas prospects in certain areas of central Alberta where drilling costs are low, and wells with high deliverability could result from any exploration success.

The lower well costs and access to flow-through share funding has enabled the Company to participate for larger interests in its recent drilling activity than it has in the past, and hence more greatly benefit from its direct marketing ability.

Czar's drilling activity has increased over prior years as follows:

	1987	1986	1985	1984
Gas Wells	22	21	11	15
Oil Wells	1	0	5	7
Dry Holes	9	6	4	5
TOTAL	32	27	20	27

In addition to Czar's exploration in central Alberta, the Company also recommenced activities in northeastern British Columbia and completed, by early 1988, five successful gas wells in that province.

Czar drilled successful wells at Drumheller, Gadsby, Mikwan, Stettler and Wimborne in Central Alberta, and in Flatrock and Helmet in northeastern British Columbia. Of most significance to Czar were the following wells:

- **Drumheller 10-12-29-19 W4M:** The Company has an 84.5% working interest in this Belly River gas well which was placed on stream in March of 1988, at a rate of 3.1 MMCF/D. The Company has similar interests in two additional Belly River wells at Drumheller, which are presently awaiting connection to market,
- **Fenn B.V. 8-22-36-20 W4M:** The Company has an 83.5% working interest, before payout, in the well which tested at 2.5 MMCF/D,
- **Wimborne 12-33-32-26 W4M:** The Company has an 83.5% working interest, before payout, in this new pool discovery which flowed gas at a stable rate of 1.6 MMCF/D,
- **Flatrock 7-13-85-17 W6M:** Gas was tested at over 6 MMCF/D from the Halfway formation in this well, in which the Company has a 19% working interest. The well is presently being connected to market,
- **Peggo d-A69-D/94-P-8:** early in 1988, the Company participated for a 42.25% working interest in the Peggo prospect, which resulted in a gas well that flowed at rates of up to 6 MMCF/D.



## Consolidated Balance Sheet

<b>ASSETS</b>	December 31, 1987	December 31, 1986 (restated)
<b>Current Assets</b>		
Cash	\$ —	\$ 2,594,661
Accounts receivable	4,941,850	3,777,206
Inventory of supplies, at lower of cost and net realizable value	360,152	317,302
	5,302,002	6,689,169
<b>Fixed Assets (note 3)</b>		
Petroleum and natural gas leases and rights including exploration, development and equipment thereon, at cost	48,457,205	43,845,608
Other	1,331,839	1,468,922
	49,789,044	45,314,530
Accumulated depletion and depreciation	(13,276,780)	(10,087,768)
	36,512,264	35,226,762
	\$ 41,814,266	\$ 41,915,931
<b>LIABILITIES</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	\$ 7,965,158	\$ 8,987,696
Current portion of long-term debt	558,996	646,583
	8,524,154	9,634,279
<b>Long-term Debt (note 4)</b>	3,682,421	18,771,417
<b>Preferred shares of a subsidiary company (note 2)</b>	37,500,000	55,000,000
<b>CAPITAL STOCK AND DEFICIT</b>		
<b>Capital Stock (note 5)</b>	47,676,092	15,880,285
<b>Deficit</b>	(55,568,401)	(57,370,050)
	(7,892,309)	(41,489,765)
	\$ 41,814,266	\$ 41,915,931

Approved by the Board:

 , Director

 , Director



## Consolidated Statement of Earnings

	Year Ended December 31, 1987	Year Ended December 31, 1986	Two Months Ended December 31, 1986
		(unaudited)	
<b>Revenue</b>			
Production	\$ 12,761,738	\$ 12,799,742	\$ 2,030,268
Less: Provincial royalties	1,620,022	1,363,499	153,006
Freehold royalties	705,709	797,421	106,596
Alberta royalty tax credit	(723,732)	(701,838)	(79,593)
	1,601,999	1,459,082	180,009
Net production revenue	11,159,739	11,340,660	1,850,259
Principal and interest from property dispositions	1,576,068	1,971,486	315,417
Processing revenue	728,825	319,518	64,747
Other	227,507	198,711	12,398
	13,692,139	13,830,375	2,242,821
<b>Expenses</b>			
Production	3,537,660	3,393,942	503,180
General and administrative	1,736,902	1,763,147	253,877
Interest on long-term debt	316,611	1,041,646	57,634
Interest — other	208,556	425,323	—
Other	—	750,000	—
Depletion and depreciation	3,423,841	2,799,409	583,040
	9,223,570	10,173,467	1,397,731
Earnings before preferred share dividends and extraordinary item	4,468,569	3,656,908	845,090
Dividends on preferred shares of a subsidiary company (note 2)	2,962,434	4,007,272	410,459
Earnings (loss) before extraordinary item	1,506,135	(350,364)	434,631
Gain on sale of subsidiary company	389,440	2,672,725	2,672,725
<b>Net earnings</b>	<b>\$ 1,895,575</b>	<b>\$ 2,322,361</b>	<b>3,107,356</b>
<b>Per Common Share (note 9)</b>			
Earnings (loss) before extraordinary item	\$0.06	\$(0.03)	\$0.02
Net earnings	\$0.07	\$ 0.17	\$0.12
Cash flow	\$0.20	\$ 0.18	\$0.04



## Consolidated Statement of Source and Use of Cash

	Year Ended December 31, 1987	Year Ended December 31, 1986	Two Months Ended December 31, 1986
	(unaudited)		
<b>Operating Activities</b>			
Earnings (loss) before extraordinary item	\$ 1,506,135	\$ (350,364)	\$ 434,631
Depletion and depreciation	3,423,841	2,799,409	583,040
Working capital provided by operations	4,929,976	2,449,045	1,017,671
Change in non-cash working capital items, net of sale of subsidiary companies	(2,230,032)	1,896,317	(569,291)
	2,699,944	4,345,362	448,380
<b>Investing Activities</b>			
Additions to fixed assets			
Current operations	(2,709,343)	(3,099,930)	(417,744)
Partnership equalization payment	—	(1,116,252)	—
Flow-through share arrangement	(2,000,000)	(2,945,000)	(2,111,000)
Collection of notes receivable (note 10)	389,440	—	—
<b>Financing Activities</b>			
Common shares issued pursuant to financial restructuring, net of costs of the issue of \$1,179,193	28,820,807	—	—
Decrease in bank loan	(14,530,000)	—	—
Decrease in liability to limited partnership	(646,583)	—	—
Redemption of preferred shares of a subsidiary company	(17,500,000)	—	—
Common shares issued and to be issued			
Pursuant to flow-through share arrangement	2,000,000	2,945,000	2,111,000
For cash	15,000	18,900	—
On liability settlement	960,000	—	—
Share issue costs	(93,926)	—	—
Discharge of limited partnership redemption obligation	—	(180,000)	—
Increase (Decrease) in cash	(2,594,661)	(31,920)	30,636
<b>Cash at beginning of period</b>	<b>2,594,661</b>	<b>2,626,581</b>	<b>2,564,025</b>
<b>Cash at end of period</b>	<b>\$ —</b>	<b>\$ 2,594,661</b>	<b>\$ 2,594,661</b>



## Consolidated Statement of Deficit

	Year Ended December 31, 1987	Year Ended December 31, 1986	Two Months Ended December 31, 1986
		(restated) (unaudited)	(restated)
<b>Beginning of period</b>			
As previously reported	\$ —	\$(58,259,511)	\$(59,044,506)
Adjustment for settlement of liability (note 6)	—	(1,432,900)	(1,432,900)
As restated	<b>(57,370,050)</b>	(59,692,411)	(60,477,406)
Share issue costs (note 5(g))	<b>(93,926)</b>	—	—
Net earnings	<b>1,895,575</b>	2,322,361	3,107,356
<b>End of period</b>	<b>\$(55,568,401)</b>	\$(57,370,050)	\$(57,370,050)

## Auditors' Report

To the Shareholders of  
Czar Resources Ltd.

We have examined the consolidated balance sheet of Czar Resources Ltd. as at December 31, 1987 and the consolidated statements of earnings, deficit and source and use of cash for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1987 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding period.

Calgary, Canada  
March 17, 1988  
(April 21, 1988 as to note 11)

Thorne Ernst & Whinney  
Chartered Accountants



# Notes to Consolidated Financial Statements

Year Ended December 31, 1987

## 1. Accounting Policies

### (a) Change of Year End

The Company has changed its fiscal year end to December 31, effective December 31, 1986.

### (b) Principles of Consolidation

The consolidated financial statements include the accounts of Czar Resources Ltd. and its subsidiary companies, which are wholly-owned.

### (c) Petroleum and Natural Gas Operations

(i) The Company follows the full cost method of accounting for petroleum and natural gas operations whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized by cost centre. A separate cost centre is established for each country in which the Company operates, presently Canada. Costs include land acquisition costs, geological and geophysical expenditures, carrying charges on non-producing property, costs of drilling both productive and non-productive wells, related overhead expenditures and capitalized interest related to major development projects. Costs of acquiring and evaluating unproved properties and certain major development projects are excluded from the depletion calculation until it is determined whether or not proved reserves are attributable to those properties or major development projects are complete or impairment occurs. Costs are depleted by cost centre using the composite unit of production method based upon estimated proved reserves after royalties. Crude oil reserves are converted to equivalent units of natural gas based on the relative energy content of each product.

(ii) Aggregate net book value in each cost centre which can be carried forward for amortization against revenues of future periods (the "cost ceiling") is limited to an amount equal to the estimated future net revenues from proved reserves, based on current prices and costs, plus the lower of cost or estimated fair value of unproved properties and major development projects. The aggregate estimated future net revenues and value of unproved properties and major development projects for all cost centres is further reduced by estimated future general and administrative expenses, financing costs and income taxes (see note 3).

(iii) Under certain drilling programs, a significant portion of the consideration for the sale of properties by the Company is receivable in installments. Principal and interest payments, in the aggregate, may not exceed a fixed percentage of net revenue from the wells drilled. Unpaid principal installments total \$40,102,264 at December 31, 1987 (December 31, 1986 — \$41,599,476). Such principal and interest payments are recorded as and when received.

(iv) All of the Company's exploration and development activities related to petroleum and natural gas are conducted with others; the Company records only its proportionate interest in such activities.

### (d) Depreciation

Depreciation of petroleum and natural gas production equipment and related facilities is provided on the composite unit of production method based on estimated proved reserves after royalties of each cost centre. Depreciation of other equipment is provided on a straight-line basis at rates which are estimated to amortize the cost of the assets over their useful lives.



## 2. Financial Restructuring

The Company and the Company's banker (the "Bank") restructured (the "Restructuring") the Company's obligations to the Bank pursuant to a Debt Restructuring Agreement effective for interest and dividend determination as of October 30, 1986, such that \$30 million of the Company's indebtedness to the Bank comprised of (a) \$2.5 million of non-interest bearing demand debt, (b) \$10.0 million of demand operating borrowings, and (c) the indebtedness of the Company incurred to enable a subsidiary company to redeem \$17.5 million of the preferred shares which had been issued by the subsidiary to the Bank as part of a 1984 restructuring, has been satisfied in exchange for the issuance to the Bank of 12,787,269 common shares (46.7% of the issued and outstanding common shares) of the Company. The Restructuring was completed on September 23, 1987 at which time the Company also issued to the Bank warrants to acquire an additional 833,659 common shares (subsequently adjusted — see note 5(d)) for no additional consideration exercisable in the event of the exercise of employee options which were in existence on October 30, 1986.

The outstanding preferred shares of the subsidiary held by the Bank in the aggregate amount of \$37.5 million ("Preferred Shares") have the following terms and conditions:

- (a) bear dividends at the rate of approximately 7.35% to February 15, 1988 and thereafter at the rate of 50% of the weighted average of the Bank's prime lending rate plus 1% payable quarterly in arrears;
- (b) are retractable at the option of the holder and redeemable at the option of the subsidiary for an amount equal to the issue price plus accrued and unpaid dividends, at any time without penalty; and
- (c) are subject to mandatory redemption or purchase from time to time based on cash flow, as described below, and in any event on or before March 15, 1989.

It is also a term of the Preferred Shares that excess cash flow of the Company (as defined) in any fiscal year in excess of \$200,000, including cash from all sources will be advanced by the Company to the subsidiary to fund the redemption of Preferred Shares. Additionally, permissible capital expenditures are deducted in determining defined excess cash flow.

The Company has agreed that the Bank will be entitled to require the Company to purchase the Preferred Shares from the Bank for an amount equal to the redemption price plus two times accrued and unpaid dividends in order to preserve the Bank's after-tax return on such purchase and upon the occurrence of certain events additional amounts to guarantee the Bank a specific after tax rate of return. Although the Bank is entitled to demand retraction of the Preferred Shares by the subsidiary or purchase by the Company at any time, the Bank has confirmed that it has no present intention of exercising such rights. The Company's obligation is secured by a fixed charge debenture on certain assets and a floating charge debenture on all assets of the Company and assignments of accounts receivable and certain petroleum and natural gas properties and revenue interests therein.

The Company has agreed with the Bank not to make any distributions, including dividends, to its shareholders without the consent of the Bank. The Company has agreed to limit its working capital deficiency to \$1,000,000 after December 31, 1988 which limit may be increased to a maximum of \$3,000,000 under certain circumstances.



### Common Share Offerings

The Company cannot, without the consent of the Bank: (i) issue common shares or rights to common shares at less than \$1.25 per share, or (ii) issue in any 12 month period common shares of the Company in excess of 20% of the common shares outstanding at the commencement of such period without the approval by special resolution of each class of shareholders, voting separately. In addition, subject to regulatory approval, the Bank is entitled to participate up to its proportionate shareholding interest in all future common share issues on the same basis as third parties other than in connection with common shares issued pursuant to stock option agreements entered into after October 31, 1986.

In the event that the Company proposes to issue common shares, other than flow-through shares, or securities convertible into common shares, the Bank has the option to participate, in the case of any public offerings at any time, or any private offering after October 31, 1988, on a secondary basis such that 50% of such offering shall be comprised of common shares then held by the Bank. Alternatively, the Bank may require that 25% of the proceeds of any such issue be paid to it and to apply such proceeds, at the election of the Company, either against the operating line as a permanent reduction of the limit thereof or to fund the redemption of the Preferred Shares, or any combination of the foregoing. See note 11.

### Operating Lines of Credit and Bank Borrowings

The Company has agreed with the Bank that for the period commencing October 30, 1986 and ending September 22, 1989, either debt to the Bank or the operating line shall be permanently reduced or the Preferred Shares shall be redeemed (to the extent not already redeemed under the share redemption requirement) or any combination of the foregoing, on an annual basis at the rate of \$400,000 plus 60% of cash flow (as defined) from operations of the Company and its subsidiaries in excess of \$2,000,000 for that particular year. The line of credit is automatically reduced, to the extent Preferred Shares are not redeemed or purchased by the fixed amount of \$100,000 per quarter and adjusted yearly in accordance with the formula. These provisions continue after September 22, 1989 if no agreement has been reached on new arrangements by that time. The operating line, \$3,755,000 at March 31, 1988, is reviewed annually and the loans are secured by a fixed charge debenture on certain assets and a floating charge debenture on all assets of the Company and assignments of accounts receivable and certain petroleum and natural gas properties and revenue interests therein. The Company is not permitted to seek additional borrowings from any person except the Bank.

## 3. Fixed Assets

Fixed assets include overhead expenditures which are incurred in the exploration and development of oil and gas properties, amounting to \$422,769 in the year ended December 31, 1987 (December 31, 1986 — \$461,392). The Company has not capitalized any interest costs or excluded costs from depletable costs in 1987 or 1986, pursuant to its accounting policies.

In determining the cost ceiling in accordance with the Company's accounting policy, management has assumed that it will be possible to obtain alternate financing with equivalent debt service requirements on maturity of the Preferred Shares. If it is not possible to obtain such financing beyond March, 1989, the Company would be required to write off the carrying value of the petroleum and natural gas assets.



#### 4. Long-Term Debt

	December 31, 1987	December 31, 1986
Bank loan, at prime plus ¼%	\$2,970,000	\$15,000,000
Bank loan, non-interest bearing	—	2,500,000
Liability to limited partnerships (note 6)	1,271,417	1,918,000
	<b>\$4,241,417</b>	<b>19,418,000</b>
Current portion of long-term debt	<b>558,996</b>	<b>646,583</b>
	<b>\$3,682,421</b>	<b>\$18,771,417</b>

The bank loan is on demand and is secured by floating and fixed charge debentures and other security described in note 2.

#### 5. Capital Stock and Deficit

##### (a) Authorized Capital Stock

- 10,000,000 First preference shares  
issuable in series
- 10,000,000 Second preference shares  
issuable in series
- Unlimited number of Common shares

(b) Issued and to be Issued Capital Stock	Number of Shares	Consideration
Balance at December 31, 1986	12,828,521	\$15,880,285
Common shares issued and to be issued		
Pursuant to flow-through share arrangement	946,616	2,000,000
For cash on exercise of stock options	10,000	15,000
Pursuant to financial restructuring net of related costs of \$1,179,193 (note 2)	12,787,269	28,820,807
To a related company pursuant to a liability settlement	480,000	960,000
Balance at December 31, 1987	27,052,406	\$47,676,092

##### (c) Common Share Options

At December 31, 1987 directors, officers and employees held options to purchase 832,000 common shares of the Company at prices ranging from \$1.50 to \$1.65 per share exercisable from time to time to July 1989.

##### (d) Common Share Purchase Warrants

At December 31, 1987 common share purchase warrants were outstanding entitling the Company's banker to purchase common shares as follows:

Number of Shares	Price (\$)	Expiry Date
232,571	1.86	May 15, 1989
232,571	1.60	October 31, 1989
232,571	2.16	October 31, 1990
232,571	1.71	October 31, 1991
232,571	2.09	September 23, 1992

The Company's banker also has common share purchase warrants to acquire 828,679 common shares at no cost which are exercisable in the event of the exercise of employee options which were in existence on October 30, 1986. These warrants expire August 1, 1989. See note 2.

##### (e) Liability Settlement

In January, 1987 the Company reached an agreement with a related party to settle a liability of \$960,000 by the issue of 480,000 common shares.

**(f) Subsequent Events (see note 11)**

- (i) On January 1, 1988, the Company instituted an employee savings plan which provides for employee savings of up to 5% of salary which will be matched by the Company in the form of common shares. The Company's contribution is not expected to exceed 80,000 common shares in 1988.
- (ii) In January, 1988 the Company issued 100,000 common shares in partial settlement of a liability to a limited partnership included in long-term debt (see note 6).
- (iii) Subsequent to December 31, 1987, the Company completed its obligations pursuant to a flow-through share arrangement by incurring exploration expenditures of \$624,000 and issuing 240,000 common shares.

**(g) Share Issue Costs**

In the fall of 1987 the Company proposed an issue of common shares. With the collapse of the equity markets, the proposed issue was discontinued and the related costs charged to the deficit.

**6. Prior Period Adjustments**

In November, 1987 the Company settled a claim by certain limited partnerships which related to the years 1981 to 1985. The settlement amount of \$1,918,000 included \$485,100 of accrued fixed asset costs and \$1,432,900 of operating expenses. Six hundred thousand dollars was paid in 1987 and the balance satisfied by the issuance of 100,000 common shares in January, 1988 and monthly installments of approximately \$47,000 until November, 1989. The Company has provided a fixed charge debenture on certain fixed assets to secure amounts owing under this settlement agreement.

**7. Income Taxes**

At December 31, 1987, the Company had approximately \$45,000,000 of tax costs in excess of net book value available to reduce future years' income for tax purposes. This potential tax benefit has not been reflected in the financial statements.

There is no provision for deferred taxes in 1987 and 1986 as there are sufficient costs for accounting purposes available to offset future earnings for a number of years. A summary of the items which reduce taxable income for accounting purposes is as follows:

	Year Ended December 31, 1987	Year Ended December 31, 1986 (unaudited)	Two Months Ended December 31, 1986
Net earnings	\$ 1,895,575	\$ 2,322,361	\$ 3,107,356
Increase (decrease) in taxable income resulting from:			
Non-deductible preferred share dividends	2,962,434	4,007,272	410,459
Non-deductible provincial royalties and lease rentals	1,812,835	2,333,222	167,421
Alberta royalty tax credits	(723,732)	(701,838)	(79,593)
Resource allowance	(1,729,453)	(1,748,717)	(288,404)
Earned depletion allowance	(816,361)	(1,334,278)	(166,560)
Application of prior years' losses	(3,401,298)	(2,205,297)	(477,954)
Sale of subsidiary companies	—	(2,672,725)	(2,672,725)
Taxable income for accounting purposes	\$ —	\$ —	\$ —



## 8. Segmented Information

The Company has a single line of business, which is the exploration for and the development and production of petroleum and natural gas in Canada. Effective December 31, 1986 the Company sold its United States operations which had a net income for the year ended December 31, 1986 of \$514,696.

## 9. Net Earnings and Cash Flow Per Common Share

Net earnings and cash flow per common share are calculated using the average number of common shares outstanding during the year of 26,194,943 (December 31, 1986 — 13,865,296). The calculation of cash flow per common share is based on "working capital provided by operations" as reflected in the Consolidated Statement of Source and Use of Cash.

### Per Common Share

	Year Ended December 31, 1987	Year Ended December 31, 1986	Two Months Ended December 31, 1986
		(unaudited)	
Earnings (loss) before extraordinary item			
— Basic and fully diluted	\$0.06	\$(0.03)	\$0.02
Net earnings — Basic	\$0.07	\$0.17	\$0.12
— Fully diluted	\$0.07	\$0.17	\$0.11
Cash flow — Basic	\$0.20	\$0.18	\$0.04
— Fully diluted	\$0.18	\$0.18	\$0.04

## 10. Gain on Sale of Subsidiary Companies

Effective December 31, 1986, the Company sold its United States subsidiaries. At the time of the sale, the consolidated liabilities of the subsidiaries exceeded the assets by \$2,672,725, the amount of the extraordinary gain reflected in the statement of earnings. The Company received two promissory notes aggregating \$2.8 million as consideration for the shares of the subsidiaries and because payment of the notes is dependent on certain future events, any additional gain will be recorded as payment on the notes is received. To December 31, 1987 the Company has received \$389,440 in respect of these notes.

## 11 Subsequent Event

Pursuant to an underwriting agreement dated April 21, 1988, the Company has agreed to sell to an underwriter \$10,000,000 of 8.75% Convertible Debentures of the Company.

The underwriter has the option to acquire up to an additional \$2,000,000 of 8.75% Convertible Debentures.

Pursuant to the restructuring, the Bank has elected to receive 25% of the net proceeds of the issue which the Company has elected to apply as a permanent reduction of the operating line of credit. See note 2.



## Corporate Information

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### Board of Directors and Officers

Robert W. Lamond, Director  
Chairman of the Board  
& Chief Executive Officer  
Calgary, Alberta

Bonita O. Rawlyck, Director  
Senior Vice President, Finance  
& Chief Financial Officer  
Calgary, Alberta

Brian C. Bentz, Director  
Vancouver, British Columbia

Charles A. Teare, Director  
Calgary, Alberta

Allan R. Twa, Director  
Corporate Secretary  
Calgary, Alberta

### Key Personnel

P. Richard Ewacha  
Vice President, Production

Sharon P. Runge  
Land Manager

Herbert J. Visscher  
Exploration Manager

Paul M. Boechler  
Controller

Donald K. Clark  
Production Manager,  
British Columbia

Philip W. Payzant  
Production Manager,  
Alberta

### Corporate Office

Suite 700, 425 - First Street S.W.  
Calgary, Alberta  
T2P 3L8  
(403) 265-0270 Telex 03-826735

### Field Office

P.O. Box 6718  
Fort St. John  
British Columbia  
V1J 4J4  
(604) 787-7718

### Legal Counsel

Burnet, Duckworth & Palmer  
Suite 3200, 425 - First Street S.W.  
Calgary, Alberta  
T2P 3L8

### Auditors

Thorne Ernst & Whinney  
Suite 1200, 205 - Fifth Avenue S.W.  
Calgary, Alberta  
T2P 4B9

### Registrar & Transfer Agent

The Canada Trust Company  
505 Third Street S.W.  
Calgary, Alberta  
T2P 3E6

### Wholly-Owned Subsidiaries

Czar Financing Alberta Ltd.  
Czar Gas Corporation Inc.

### Stock Listings

The Toronto Stock Exchange  
The Alberta Stock Exchange  
Trading Symbol — CZR



**CZAR**  
RESOURCES LTD.

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Product prices received by the Company for oil and gas sales averaged:

	1987	1986
Gas — \$/MCF	\$ 1.37	\$ 1.82
Oil & natural gas liquids — \$/BBL	\$18.50	\$21.25

The continued effects of deregulation and competition in the natural gas business further reduced the average price of Czar's gas sales. With greater demand as the winter heating season nears, it is anticipated that a firming in gas prices, presently underway, will become more apparent.

Oil prices recovered substantially during 1987, however Czar's high proportion of natural gas liquid volumes received historic low prices during the period, resulting in a year over year reduction in average oil and NGL prices.

During the first half of the year, Czar resumed direct sales to its United States industrial purchasers which helped to offset lower takes from industrial users in British Columbia. In addition, higher levels of sales to long term contracts allowed Czar to increase the level of gas sales over 1986.

The Company commenced additional direct sales to industrial users in both Ontario and Quebec during the period and anticipates further growth in industrial sales to the eastern Canadian market region during 1987.

	SIX MONTHS	
	1987	1986
	Billions of Cubic Feet*	
Alberta — Industrial	4.9	4.5
B.C. — Industrial	2.9	4.7
Export	1.1	0.6
Total	8.9	9.8

\*Includes Czar and partners.

During the first six months of 1987, Czar participated in six wells all of which were cased as successful gas wells.

Subsequent to the reporting period, the Company participated for an 84.5% working interest in a second successful well in the Drumheller area of Central Alberta. The well, Drumheller 6-30, encountered two gas sands in the Belly River formation, both of which flowed on production test at a rate of 1.6 million cubic feet per day. As this well is located close to a trunk line meter station, it is anticipated that the well will be placed on stream within the next ninety days and should be a major contributor to the Company's revenues.

The short term outlook for the Canadian energy business is at the most optimistic level in a number of years due to the recent rebound in oil prices, the availability of funding and the consensus that at this phase of the economic cycle, increasing North American industrial activity and slowly accelerating inflation would be beneficial to the industry.

With Czar's more stable financial position now attracting outside interest, the Company is presently examining a number of financing alternatives to further improve its long term financial strength.

R. W. Lamond  
President

August 21, 1987



CZAR RESOURCES LTD.

Suite 700, 425 First Street S.W.  
Calgary, Alberta T2P 3L8

6 MONTHS ENDED  
JUNE 30, 1987

INTERIM REPORT  
TO SHAREHOLDERS



## TO THE SHAREHOLDERS

On behalf of the Board of Directors I am pleased to report improved financial results for the six-month period ended June 30, 1987, despite lower average energy prices received by Czar during the period than those of the prior year.

The beneficial impact of Czar's financial restructuring is now apparent as lower debt service costs more than offset reduced production revenue.

Product price declines during 1987 resulted in a reduction in gross revenue to \$7.5 million despite production levels which were slightly higher than those of 1986.

Improved operating efficiencies and a substantial reduction of debt servicing costs increased cash flow to \$3.0 million from \$2.9 million reported in 1986, while earnings of \$1.3 million were the same as the prior year.

As a result of a refinancing between Czar and its banker, interest and dividend charges for the period were reduced by \$1 million. Debt to the Bank aggregating \$30 million will be converted into an equity position in the Company. While this transaction is effective October 30, 1986, as to debt servicing charges, formal closing awaits a Revenue Canada tax ruling.

The Company continued to be cautious in making expenditures on fixed asset additions and reinvested only \$1 million, or 33% of cash flow from operations. In addition, the Company expended \$577,000 pursuant to a flow-through share agreement with National Investors Management Ltd.

The Company is presently in a satisfactory financial condition in that the combination of available exploration funding, cash reserves of approximately \$1.6 million and ongoing cash flow will enable the Company to undertake a variety of projects in the fall and winter drilling seasons.

For the six-month period, Czar's net production volumes from Canadian operations, before royalties, were:

Natural gas — MMCF/D	1987	1986
Oil and natural gas liquids — BOPD	25.8	23.3
	403	501

Continued success in the gas marketing field enabled the Company to increase its net gas production by over 2 million cubic feet per day, while reduced oil production resulted from the natural decline of the Company's wells and a short term reduced allowable on one of the Company's higher interest properties.

### CZAR RESOURCES LTD. CONSOLIDATED STATEMENT OF EARNINGS SIX MONTHS ENDED JUNE 30, 1987 (unaudited)

	1987	1986
Production	\$ 7,143,292	\$ 8,067,739
Less: Provincial royalties	935,076	979,531
Freehold royalties	425,816	520,313
Alberta royalty tax credit	(341,452)	(305,189)
Net production revenue	1,019,440	1,194,655
Principal and interest from property dispositions	6,123,852	6,873,084
Other	876,698	1,225,488
	522,195	497,886
	7,522,745	8,596,458
Production	2,004,787	1,991,519
General and administrative	830,350	1,003,777
Interest on long-term debt	198,664	591,586
Interest — other	—	72,300
Depletion and depreciation	1,745,978	1,599,023
	4,779,779	5,258,205

Dividends on preferred shares of a subsidiary company	1,396,932	2,017,379
	\$ 1,346,034	\$ 1,320,874

Net earnings — Basic	\$0.11	\$0.11
— Fully diluted	\$0.05	\$0.11
Cash flow — Basic	\$0.24	\$0.25
— Fully diluted	\$0.11	\$0.25

### CZAR RESOURCES LTD. CONSOLIDATED STATEMENT OF DEFICIT SIX MONTHS ENDED JUNE 30, 1987 (unaudited)

	1987	1986
	\$ (55,937,150)	\$ (58,185,514)
	1,346,034	1,320,874
	\$ (54,591,116)	\$ (56,864,640)

### CZAR RESOURCES LTD. CONSOLIDATED STATEMENT OF SOURCE AND USE OF CASH SIX MONTHS ENDED JUNE 30, 1987 (unaudited)

	1987	1986
Net earnings	\$ 1,346,034	\$ 1,320,874
Depletion and depreciation	1,745,978	1,599,023
Working capital provided by operations	3,092,012	2,919,897
Net change in non-cash working capital items	(2,174,945)	(1,246,821)
	917,067	1,673,076
Additions to fixed assets		
Current operations	(1,034,567)	(1,590,270)
Flow-through share arrangement	(576,985)	—
Increase (decrease) in bank loan	(390,000)	—
Common shares issued and to be issued pursuant to flow-through share arrangement	576,985	—
Common shares issued for cash	7,500	—
Discharge of limited partnership redemption obligations	—	(180,000)
Increase in cash	(500,000)	(97,194)
	2,594,662	2,608,129
	\$ 2,094,662	\$ 2,510,935



**CZAR**  
RESOURCES LTD.

## Company Profile

October, 1987

**Czar Resources Ltd.** is a Calgary based energy company whose primary business is the exploration for and production of natural gas in Alberta and British Columbia, Canada.

The Company's strengths include an experienced management team, a balance of gas reserves between Alberta and British Columbia, a diversity of gas contracts, extensive undeveloped land holdings and a recently restructured balance sheet.

Czar's company plan is to expand its gas exploration and marketing efforts while maintaining and improving its current financial position.

## Financial

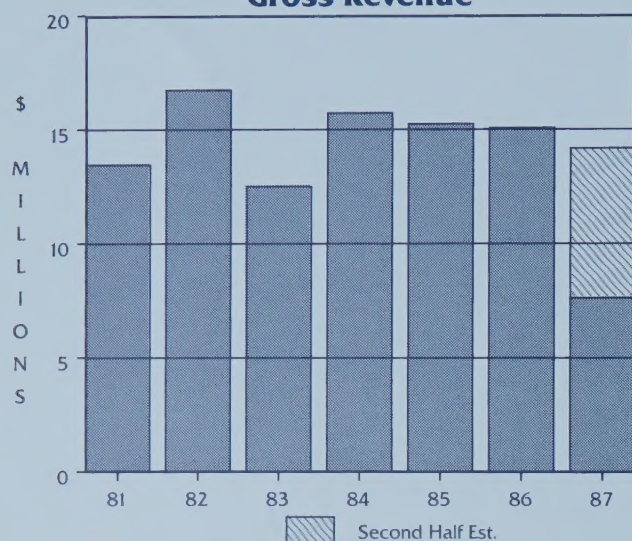
The Company's viability was badly impaired in 1981 due to excessive debt resulting from over-expansion during the early 1980's exploration boom. Since then, cost reductions, tight financial control and the prudent use of the Company's cash flow has enabled Czar to hold its asset base intact, expand its gas production capacity and develop an expertise in the direct marketing of natural gas.

Czar has managed to successfully cope with the drop in energy prices in 1986 and the present low gas prices, but a recently concluded financial restructuring has now placed it in a stable financial position.

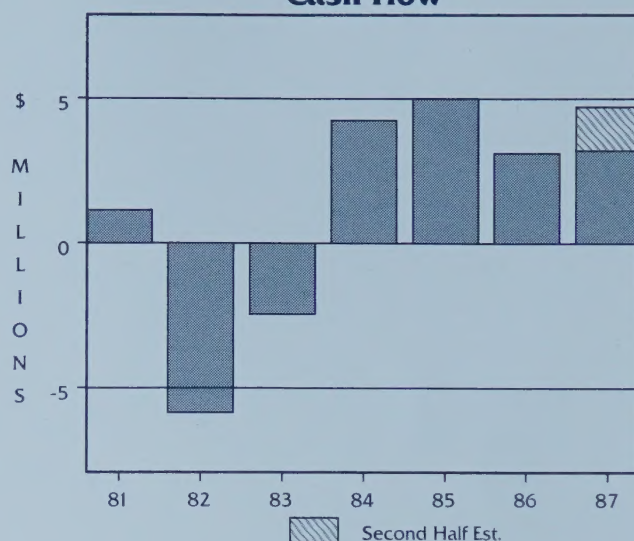
With improved operating efficiencies since 1982, Czar has maintained revenue and reduced expenses resulting in an increase in cash flow from a negative \$6 million in 1982, to \$3.5 million in 1986. On September 23, 1987, the Company concluded a deal to issue 12.8 million common shares at \$2.35 per share to retire \$30 million of the Company's debt. The restructuring, which will save Czar about \$2.4 million per year of financing charges, results in total liabilities being reduced to \$37.5 million of term preferred shares and \$4.0 million of floating rate debt. The effective date of the reduced financing charges was October 30, 1986.



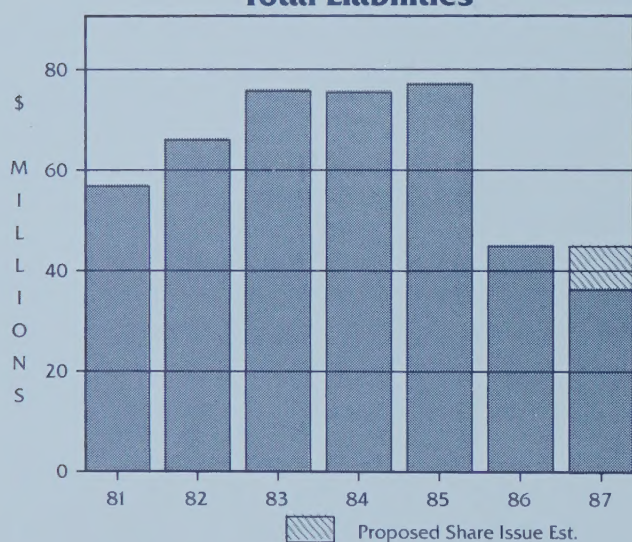
### Gross Revenue



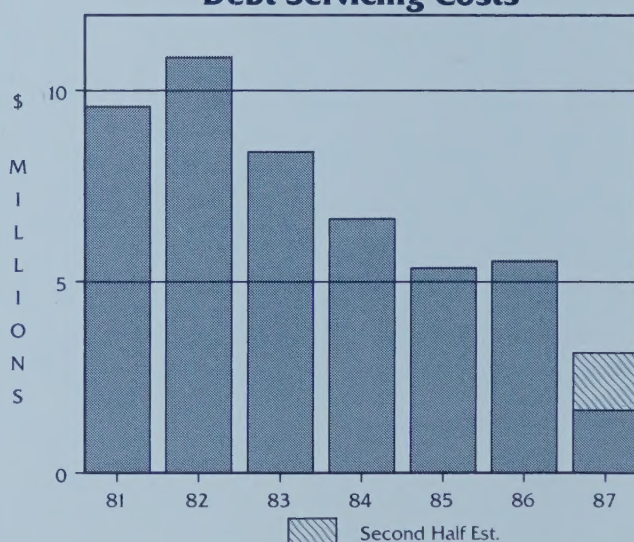
### Cash Flow



### Total Liabilities



### Debt Servicing Costs

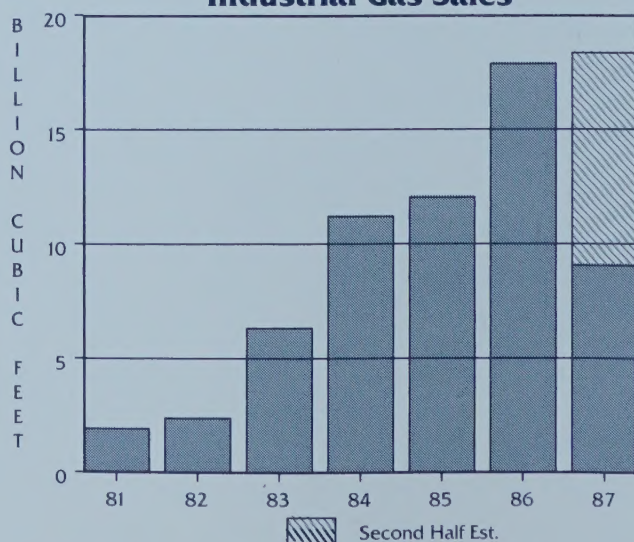


## Gas Marketing

Czar Resources Ltd. was one of the first companies in Alberta to commence the direct marketing of natural gas to industrial users. Through a long term discount contract, deliveries commenced in early 1981 to the Sherritt Gordon fertilizer plant in Fort Saskatchewan, Alberta.

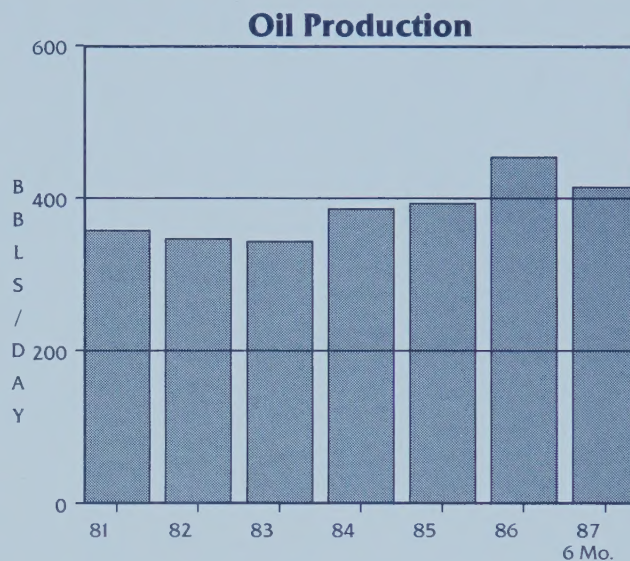
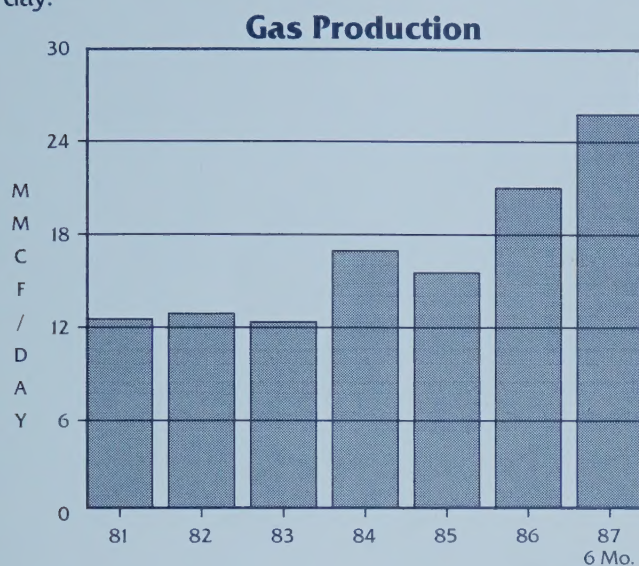
Czar presently delivers gas to 11 industrial users across Canada and the United States, with maximum volumes of 65 million cubic feet per day. As Czar markets gas on behalf of itself and its working interest partners, it is able to exert a significant market influence due to the volumes involved, and consequently direct sales managed by Czar have grown from 2 billion cubic feet in 1981 to over 18 billion in 1986.

### Industrial Gas Sales



## Production

Czar's natural gas production has almost doubled over the last five years, to average 25.8 million cubic feet per day for the first six months of 1987, while oil and natural gas liquids production has increased more slowly to presently average 403 barrels per day.



## Reserves

The following summary of an independent evaluation of Czar's oil and gas reserves was prepared by Shaw McLure Petroleum Engineering Ltd., effective December 31, 1986. Proved and probable reserves totalled 202 billion cubic feet of natural gas and 1.9 million barrels of oil and natural gas liquids.

Based on 1986 production, Czar has a reserve-life index of over 25 years for gas and 18 years for oil and natural gas liquids.

### Engineering and Economic Evaluation at December 31, 1986

	Petroleum and Natural Gas Liquids (MSTB)	Natural Gas (MMCF)	Estimated Future Net Revenue Before Income Taxes (in thousands of dollars)			
			Undiscounted	Discounted at		
				10%	15%	20%
Proved Producing	1464.8	76,525	\$135,141	\$ 62,668	\$48,657	\$39,713
Proved Non-Producing	260.6	68,325	123,994	34,996	21,514	14,061
Proved Undeveloped	54.6	15,993	31,459	7,092	3,776	2,077
Total Proved	1780.0	160,843	290,594	104,756	73,947	55,851
Probable	138.6	41,534	66,728	16,209	8,879	5,059
Total Reserves	1918.6	202,377	\$357,322	\$120,965	\$82,826	\$60,910

- 1) Reserves are before royalties
- 2) The price forecast for oil was based on \$17.50 U.S. per barrel in 1987 and escalated. The price forecast for natural gas was based on 1987 prices ranging from \$1.07 for industrial gas to \$1.90 for system gas in Alberta, and \$1.41 in British Columbia, and escalated.
- 3) The foregoing figures are before income taxes. The Company has significant tax pools which will offset tax liabilities for a number of years.

## Exploration

Czar has funded its ongoing exploration and development activities through a combination of cash flow and flow-through share issues and has avoided increasing its debt leverage. Over \$5 million of flow-through funds have been raised to date and, coupled with the new Federal government incentive programs, will enable Czar to conduct an active program during the 1987-88 winter drilling season.

The Company has directed its efforts almost exclusively to exploring for natural gas in order to improve both its long term reserves and short term deliverability. Czar also attempts to limit the number of wells drilled annually to those in which its working interest exceeds fifty percent, with the aim of marketing gas from new high interest wells through the Company's direct sale contracts.

The Company's exploration is concentrated in areas of the Western Canadian sedimentary basin in which Czar has been successful and has built up a substantial information base and expertise. Hence, ongoing development work is centered on shallow Cretaceous gas sands in the Stettler-Drumheller region of Central Alberta, as well as Triassic and Devonian prospects adjacent to the Monias and Helmet gas fields of Northeast British Columbia.

## Outlook

The steady decrease of natural gas reserves in the Lower 48 United States, the low level of replacement drilling and the likelihood that the main competing fuel, crude oil, will have trended upwards in price over the next five years, provide excellent commodity fundamentals for a rapid gas price escalation.

Czar is optimistic about the future for natural gas companies in North America and is positioning itself to benefit from anticipated future gas price rises in the early 1990's.

With a more stable financial base, management is now able to resume an active expansion of the Company's assets while maintaining close financial controls.

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### Board of Directors

Robert W. Lamond  
Chairman of the Board  
& Chief Executive Officer

Bonita O. Rawlyck  
Senior Vice President, Finance

Brian C. Bentz

Charles A. Teare

Allan R. Twa  
Corporate Secretary

### Key Personnel

P. Richard Ewacha  
Engineering Manager

Sharon P. Runge  
Land Manager

Herbert J. Visscher  
Exploration Manager

Paul M. Boechler  
Controller

Donald K. Clark  
Engineering Superintendent,  
British Columbia

Philip W. Payzant  
Engineering Superintendent,  
Alberta

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### Stock Listings

The Toronto Stock Exchange  
The Alberta Stock Exchange  
Trading Symbol - CZR

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